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PUC·Staff·Exhibit·No.·42¶
SOAH·DOCKET·NO.·473-21-0538¶
PUC·DOCKET·NO.·51415¶

SOAH DOCKET NO. 473-21-0538
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SOUTHWESTERN ELECTRIC POWER COMPANY'S RESPONSE TO COMMISSION STAFF'S NINTH REQUEST FOR INFORMATION

Question No. STAFF 9-20:

Refer to the answer to question Staff 9-19.

a) If any of SWEPCO's taxable losses were used to reduce the amount of consolidated taxable income or consolidated taxes paid by the AEP consolidated group, has SWEPO received any payments or other compensation from its parent or affiliates for the use of such losses?
b) If SWEPCO has received payments or compensation for the use of such losses, please provide by year the amounts received by affiliate and provide detailed calculations with explanations of how such amounts were determined.
c) Please provide the journal entries recorded by SWEPCO related to each payment received.
d) If SWEPCO received such payments during the test year, where are theyreflected in SWEPCO's requested revenue requirement and where are theyreflected on Schedule A-4 (3/31/20 trial balance)?
e) If SWEPCO received such payments during the test year and the payments are not reflected in its requested revenue requirement, why not?
f) If any of SWEPCO's taxable losses reported on Schedule G-7.13(f) were used to reduce the amount of consolidated taxable income or consolidated taxes paid by the AEP consolidated group, and SWEPCO did not receive compensation for the use of such taxable net operating losses, why did it not receive compensation?

Response No. STAFF 9-20:

a) Yes, SWEPCO participates in the AEP consolidated federal return and its Tax Allocation Agreement. The agreement states that the holding company will provide a payment to any tax loss member equal to "the amount by which the consolidated tax is reduced by including the member's net corporate tax loss in the consolidated tax return." AEP affiliates receiving any payment from the holding company under the tax allocation agreement as the result of tax losses are therefore dependent upon other companies within the consolidated group generating taxable income. Any such payments received by a loss affiliate represent the tax obligation of income affiliates that have been deferred as the result of filing a consolidated return and are not the direct result of the regulated operations of the loss affiliate. Under the Tax Allocation Agreement SWEPCO has received payments from AEP Inc. as a result of its losses as reported on Staff 9-19 Attachment 1.

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b) See Staff 9-19 Attachment 1 for a schedule of the utilization of SWEPCO's NOL by the AEP consolidated group by tax return year. The tax sharing agreement (Staff 9-17 Attachment 1) provides the method in which any cash allocations are calculated.

c) An example of journal entries to record the consolidated tax sharing agreement are as follows:

Subsidiary A
Debit – Income Taxes Payable (Account 236)
Credit – Cash
AEP Inc.
Debit – Cash (From Subsidiary A)
Credit – Income Taxes Payable (Account 236)

Debit – Income Taxes Payable (Account 236)
Credit – Cash (To SWEPCO)
SWEPCO
Debit – Cash
Credit – NOLC Deferred Tax Asset (Account 190)

d) SWEPCO participated in the consolidated tax allocation agreement during the test year. As a result of other companies within the group generating taxable income, SWEPCO received payment from the holding company under the agreement. As indicated in the response to part c) of Staff 9-20 the payment received by SWEPCO is recorded as both a credit to the deferred tax asset account and a debit to cash. Because the receipt of cash through the tax sharing agreement reduces the deferred tax asset balance for the NOL carryforward, the trial balance reflects the full DTL associated with accelerated depreciation.

e) The requested revenue requirement is based on the recognition of a separate return net operating loss carryforward deferred tax asset as a component of the ADFIT included in rate base. The federal income taxes requested by the Company are based on revenues and expenses included in the cost of service calculation. The use of a separate return approach to the income taxes requested prevents the cross-subsidization of costs or benefits among affiliate companies.

As described on pages 12-13 of the direct testimony of Company witness David Hodgson, the proforma adjustment to reflect SWEPCO's NOL on a separate return basis is consistent with the normalization rules of the Code. The specific normalization provisions of the Code that guide the Company's proforma adjustment in this case include –

- Treasury Regulation Section 1.167(l)-1(h) and accompanying IRS rulings directly addressing instances in which accelerated depreciation produces NOLs, and

- Internal Revenue Code Section 168(i)(9)(B) which requires consistency among the assumptions used for determining the revenue requirement elements of book depreciation expense, income tax expense (the book-to-tax differences used to compute current and deferred income tax expense), and the rate base components for accumulated deferred income taxes and net book value.

As discussed by witness Hodgson on page 12 of his direct testimony, the IRS has issued a number of private letter rulings which determine that NOL carryforward ADFIT must be included in rate base when the NOL is associated with accelerated depreciation. As stated on page 28 of the direct testimony of Company witness Hodgson, the Company performed a with-and-without test which determined that the NOL carryforward is a result of accelerated depreciation. Because SWEPCO's NOL carryforward is a result of accelerated depreciation, including the proforma adjustment is consistent with the normalization requirements of the Code.

f) SWEPCO has received payments from its parent company, AEP, Inc.

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